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Developing a Model of Tax Compliance from Social Contract Perspective: Mitigating the Tax Evasion

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Abstract

The objective of this study is to develop a tax compliance from social contract perspective as mitigation to tax evasion. It is argue that the social contract is an agreement between people and state. The state create prosperity together and as a consequence the country requires a commitment from people through tax payments. The study uses a qualitative interpretative approach. This study results indicate that model of tax compliance can be develop through the perspective of social contract theory based on the freedom, common interests and reciprocity.

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Keywords: social contract; principle of freedom; principle of common interest; principle of reciprocity.

1. Introduction

One major problems of low tax compliance in a country is the high tax evasion. Tax evasion is reprehensible acts committed by taxpayer or expert advisors that deliberately violating the provisions of tax legislation (Zain, 2007, p. 45). Tax evasion is a taxpayer resistance to law provisions. Taxpayers as rational human beings make assumption that when they pay taxes, they should get the benefits from the tax payment. Rationalism of taxpayer is motivated by perception that tax is a cost. The costs perception have led to a reference that payment of taxes should be streamlined. One measure to lower the tax is tax evasion.

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Taxpayer resistance to pay taxes is also motivated by principle that every economic sacrifice must give economic benefit as return. When paying the taxes, taxpayer will not get a direct return for the tax payment but the benefits will be provided in form of public service, good facilities and infrastructure built by government as results of tax payments. The problems exist if return from tax payment cannot be felt by taxpayer. For example, Russia had a bad experience when taxpayer compliance level reached the lowest figure of 26%. Low tax compliance in Russia was happened because of taxpayer distrust to government in relation with accountability of tax revenue management. Taxpayer criticized the government's performance because of high and massive corruption and government failure to provide public services; it makes taxpayer refuse to pay taxes (Rothstein, 2000)

Based on Russia's case, performance of tax collection in Indonesia was also concerned. The current data from Directorate General of Taxation shows that from 250 million population of Indonesia, number of people who have jobs are 44.8 million people, but they who have a Taxpayer Identification Number (TIN) is only 26.8 million. From 26.8 million, only 10 million taxpayers report the tax return. Meanwhile, 1.2 million corporate taxpayers who have a TIN, only 550 thousand were reported the tax return.

As anticipation of lower tax compliance, government more focuses on approach to create a deterrent effect by providing sanctions and administration fines. Allingham and Sandmo (1972) uses Theory of Economic Crime to understand behaviour of tax compliance, explains that taxpayer is not afraid to fines and administrative sanctions if the utility gained for tax evasion is greater than the fines and penalties. This study result show that taxpayers who do tax evasion more motivated by principle of cost and benefit. Risk calculation also motivates the tax evasion. Taxpayers as rational human beings will do evasion that if evasion detection is lower than acceptable risk (Alm, McClelland, & Schulze, 1992)

For Indonesia, high cases of corruption committed by bureaucrats, both at regional and centre, become an important concern for taxpayer. Perceptions are formed by taxpayer, that tax payment is used for construction of public facilities and infrastructure, such as highway facilities, schools, bridges, hospitals, health centres, subsidized food, clothing and shelter. But the fact is different. Tax revenue actually becomes a means to share the money among officials. News in Republika (online), Thursday, March 7, 2013 show news cases of corruption committed by public officials.

> "*.... District Government Association of Indonesia (APKASI) shows there are 222 regions head in Indonesia who were suspected as corruptor....*"

Both the taxpayer and government should analogize tax liability as a social contract between the taxpayer and government. The taxpayer is committed to pay taxes and government is committed to use the tax payments as fund source to create prosperity for entire community. Based on above description, this research purpose is to explain how to build tax compliance from social contract perspective. This research will generate model of tax compliance as a constructive thinking that useful for government to understand the taxpayer behaviour as an effort to improve tax compliance.

2. Social Contract Theory

Emergence of social contract theory is pioneered by several well-known scientists as Thomas Hobbes and Jean Jacques Rousseau. Hobbes develops contract social arguments with assumption that humans are rational beings who have freedom to control their own lives without the need to be bound by law provisions. Human, in Hobbes view, is exclusive and selfish and will pursue their best interest. Hobbes sees human has extensive freedom, including freedom to control economic assets to maximize wealth of each individual in any way as an effort to sustain life (Friend, 2004). Autonomy becomes a superior character in social contract theory of Hobbes. All resources and efforts will be made by humans in order to sustain life, including deceit, fraud, theft and murder as the implementation of their freedom. While Rousseau thought about the social contract also begins with assumption that human beings as free creatures.

Rational human freedom is temporary in Hobbes and Rousseau view. For Hobbes, man starts to feel capacity the limitations to survive if live alone and exclusive. While Rousseau argues that in long term humans cannot maintain their ownership own, they need other institutions to provide protection against their economic assets. Rousseau explains a child who despite having freedom from birth but bound by regulations from family of a father who can arrange their lives to obtains welfare (Rousseau, 2006, p. 3). Consistent with Rousseau, Hobbes considers humans in long run will fear of economic assets loss that can threaten their survival (Friend, 2004). To anticipate the anxiety and worry, Hobbes and Rousseau proposed an idea of social contract.

Social contract makes human sacrifice his freedom, as stated Rousseau “what man loses by the social contract is his natural liberty and an unlimited right to everything he tries to get and succeeds in getting” (Rousseau, 2006, p. 14). In social contract, Rousseau also emphasize on common will as a power and spirit to realize the goodness and common interests (Wattimena, 2007, p. 56). Rousseau explains “...we reach the same conclusion that the social compact sets up among citizen an equality of such a kind, that all bind themselves to observe the same conditions an should therefore all enjoy the same rights” (Rousseau, 2006, p.23).

Rousseau also emphasizes in social contract theory that system must provide reciprocal contracts for two parties, namely the people and government. Contract stipulation is based on an agreement of two parties. Rousseau explained, that people will surrender their resources to state with a condition that the state also returns with the same amount “....I give you all my goods, on condition that you give me back as much of them as you please...” (Rousseau 2006, p. 77). Social contract of Rousseau raised three main principles, namely the liberty, common needs and reciprocity.

Meaning of taxes payment in social contract theory is people surrender their economic independence through the taxes payment in order to realize common interests to state. As the return, state through elected governments uses the tax payments to create prosperity for all people.

3. Tax Compliance Model

It is not easy to achieve tax compliance. Various approaches have become references for government to increase tax compliance, including traditional approaches that focus on supervision, sanctions and administrative fines (Pope & Mohdali 2010; Raskolnikov, 2009; Snavely, 1990; Whait, 2012). Australian Tax Office (ATO) has theoretical approach to understanding the motivation of taxpayer compliance as measured by social distance (Braithwaite, Murphy, and Reinhart, 2007). Kirchler, Hoelzl, and Wahl (2008) developed a model of tax compliance with fiscal framework called the slippery slope. The model uses three dimensions, namely: the government as power of authorities, trust in authorities, and tax compliance. Models of tax compliance in above description can become references for government to understand taxpayer’s behaviour and as efforts to improve taxpayer compliance. Therefore, taxpayer does not only use the compliance approach that emphasizes on sanctions and administrative fines.

4. Tax evasion

Tax evasion is an action to violate the provisions of law. Examples of tax evasions are underreporting income and sales, overstating deductions, exemptions and tax credit and errors in filling out tax returns (Alm, 1999). Tax evasion becomes a serious threat to tax revenue because the consequences will effect on government budget allocation. In addition, tax evasion also provide additional burden for obedient taxpayers as they absorbs the burden of higher taxes to compensate for unpaid by tax (Moohr, 2009)

This study used a qualitative approach with interpretative research methods. Interpretative qualitative research is focused on researcher interpretation on phenomenon as research object. Interpretative research gives an important role to researchers to interpret and give meaning as a form of reflection on research phenomenon (Raco, 2010). Characteristics of qualitative research methods is to build a concept inductively, so that research results of qualitative approach cannot be generalized as in quantitative research by using a representative sample of population. Informants in this study were two individual taxpayers who have income from business and bookkeeping to calculate the tax payable income.

5. Tax Collection and Social Contract

Contract is a commitment or pledge agreed by both parties, although only a metaphor because there is no signature above paper between the taxpayer and government. In taxation context, taxpayer is party who offers while the government accepts the offer. Taxpayer offer is to provide economic resources to obtain welfare, whereas the government accepts the offer and use the economic resources to create wealth for society. Contract idea of Rousseau and Hobbes provide three principles for government to fulfil taxpayer compliance. They are freedom, common interests, and reciprocity principle.

The background of social contract is man freedom to control economic resources in order to survive. Government stakeholders should be aware that taxpayer has to sacrifice the economic resources to pay the taxes that will be enjoyed by all people who do not pay the tax. In fact, taxpayers feel that tax payment have not been managed optimally for society welfare, as told by informants as follows:

> "***..... Please imagine! The money collected from the public tax payments is used for what? Corruption of political parties?***

Social contract perspective is built to control the taxpayer's freedom to become rational and more selfish through ownership of their economic resources. With social contract, taxpayer's freedom is under government control as an elected institution to regulate people's welfare. Government's role still not maximal to create people prosperity as expected. It makes taxpayer makes his freedom action through tax evasion. Tax evasion becomes rationalization of taxpayers to restate their freedom that has been given to government, although it violates ethics laws and regulations.

The human social contract perspective has been made the taxpayer as an individual who give the individual freedom into common freedom. Through taxes payment, taxpayer distributes economic resources owned in order to be distributed evenly by government to whole society. Giving their freedom into common freedom makes taxpayer no longer think collegially. But taxpayers feel that their sacrifice was not followed by implementation of legislation provisions rightly, as told by informant below:

> "***..... If the application of rules is substandard or different for all businessmen, it can make a bankrupt. We dutifully pay the tax, but our competitors do not pay the tax. If regulations are standardized, it will run smoothly.....*** "

Informants reported that implementation of tax provisions are substandard. It means that there are taxpayers who carry out the provisions of law, but there are also taxpayers who violate the provisions of law. Law uncertainty would undermine the principle of common interest of taxpayer through tax payments.

Taxpayer has implemented the mutual interest principle to establish tax compliance. Tax compliance is no longer motivated by neoclassical paradigm where taxpayer is rational, selfish and purely economical, but they are motivated by aspect of social norms, morality, altruism and justice (Alm, 2013). Government should realize that there has been a reasoning shift to understand why taxpayers pay the taxes. Therefore, government must promote the principle of common interest of taxpayer to tax administration system to create a good environment to maintain the commitment of taxpayer compliance.

Returns received by taxpayer for the tax payment are good public service, adequate public facilities and infrastructure, such as roads and bridges, schools, health centres, and hospitals. Public service benefit is a manifestation of reciprocity principle. Benefit from tax payment in Indonesia is still not maximum. Poor public services, public facilities and infrastructure are inadequate, and corruption is real examples government's contract violation with taxpayer, as informed by viva.co.id below:

> "***..... The five ministries that received red report to improve the standard of public services are Ministry of Public Works, Ministry of Education and Culture, Ministry of Social Affairs, Ministry of Agriculture, and Ministry of Manpower and Transmigration .....***"

Cases of tax evasion were committed by Indonesian horrendous tax apparatus, namely Gayus Halomoan Tambunan. It breaks the taxpayer's confidence to affect the taxpayer compliance to pay their tax liability. Informants also explained that state is still not maximum to give return from their tax payments, as told by informants below:

> "***..... Managing country properly will make the taxpayer more willing to pay taxes. But what is happened in Indonesia? Better to pay tax for orphanage ... it is clearer. Rather than pay the tax to state, but it is corrupted.....*** "

In some countries such as Nigeria, Russia and Tanzania, taxpayer correlates between the taxes payment and benefits in form of adequate public services. Taxpayer stated that they would willingly pay taxes if they get real benefits from the government for such payments (Bodea & Lebas, 2014; Fjeldstad & Semboja, 2001; Rothstein, 2000).

Governments need to understand that tax evasion by taxpayer cannot solved by sanctions and fines as a deterrent. But in a different dimension, a taxpayer may become resistant and attack behind the government by questioning the commitments and seriousness of government to provide public services (Alm, 2013). Taxpayers build a perception that tax payment is identical with benefits and costs principle. Costs of taxpayer in form of tax payments must be commensurate with benefits that will be received in form of public service (Prabhakar, 2012)

Together with poor public services that become hot highlight of taxpayers, corruption of bureaucrats and bureaucracy are the reason for taxpayers to evade taxes (Picur & Belkaoui, 2006). Picur and Belkaoui (2006) describes a survey over 30 developed and developing countries that high tax compliance is high if the government did a maximum supervision of budget and possibility of irregularities in bureaucracy. Jordan can become a benchmark, one solutions offered to prevent tax evasion is to get the trust back from the taxpayer after a negative stigma attached to government (Malkawi & Haloush, 2008)

6. Tax Compliance Based Social Contract For Tax Evasion Mitigation

There is a relationship between the social contract principles and tax evasion. Tax administration systems to promote voluntary compliance are very difficult if upheld by deterrent effect as administrative fines for tax evasion mitigation. Basically, people will not violates the provisions of law because fear of the violation consequences. But they think that the crime is not the action that they choose (Wikstrom, Tseloni, and Karlis, 2011). Taxpayers in Turkibahkan said that tax evasion is not a serious crime. They are not afraid of deterrent effect that will be accepted from tax evasion (Benk, Slaves, Puren, and Erdem, 2015). Irianto and Jurdi (2005, pp. 119-120) explains that taxpayer has regarded the obligation to pay the tax as part of social contract that has been agreed with government. Not only an obligation, taxpayer also demands the fulfilment of his right within social contract.

Tax evasion by taxpayers not only for profit but rather as a way to address non seriousness of government to fulfil the taxpayers rights within social contract. These rights are availability of adequate public services, tax revenue management that free from abuse, and breaking the long chains of bureaucracy. Conversely, if the taxpayer rights are not met, tax evasion becomes a justification for taxpayer.

7. Conclusion

The taxpayers bind their liberty to government within a contract which obliges them to give economic resources for common welfare. The consequence is government must fulfil taxpayer right as a benefit on tax payment commitment through the availability of adequate public services and transparency and efficiency in tax revenue management.

Taxation in a social contract perspective is based on quality of government's performance to manage country's financial from tax revenue. If the government gives high performance in providing high-quality public services, benefits of these tax payments can be received by taxpayer in order to create a good environment for tax compliance as mitigation of tax evasion.

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